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DIVISION OF CONSUMER ADVOCACY
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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

PUBLIC UTILITIES
COMMISSION

2007 SEP 10 P 3:59

FILED

In the Matter of the Application of)
HAWAIIAN ELECTRIC COMPANY, INC.)
Approval of Rate Increase and Revised Rate)
Schedules and Rules.)

DOCKET NO. 2006-0386

DIVISION OF CONSUMER ADVOCACY'S
RESPONSES TO HECO'S INFORMATION REQUESTS

Pursuant to the Stipulated Settlement Letter filed by the Parties on
September 6, 2007, the Division of Consumer Advocacy submits its **RESPONSES TO**
HECO'S INFORMATION REQUESTS TO CA-T-3 in the above docketed matter.

DATED: Honolulu, Hawaii, September 10, 2007.

Respectfully submitted,

By Cheryl S. Kikuta
CHERYL S. KIKUTA
Utilities Administrator
DIVISION OF CONSUMER ADVOCACY

DOCKET NO. 2006-0386

HAWAIIAN ELECTRIC COMPANY, INC.

DIVISION OF CONSUMER ADVOCACY'S

RESPONSES TO HECO'S INFORMATION REQUESTS

Mr. Carver, CA-T-3 is sponsoring the responses to the following information requests.

HECO/CA-IR-301 **Ref: CA-101 Schedule B-3.**

Footnote (c) contains a calculation of the O&M Non-Labor payment lag days.

- a. Please provide a detailed schedule of amounts comprising the total "Other Non-Labor O&M" expense of \$101,225,000.
- b. Please provide a reconciliation of the differences in the "Other Non-Labor O&M" expense of \$101,225,000, and the "Other Non-Labor O&M" expense of \$97,974,000 presented by HECO in response to DOD-IR-100, page 9. Please provide explanations or references for each reconciling item.

RESPONSE: Pursuant to the Stipulated Agreement reached between the Parties, the adjustment reflected on Schedule B-3 has been resolved. As a result, the Consumer Advocate will not provide a response to this information request, consistent with the understanding between the Parties that responses would not be required for those issues that were settled.

HECO/CA-IR-302 **Ref: CA-304.**

In each rate case, a portion of the test year NPPC is transferred to plant and, therefore, is not included in test year expenses. What is the basis for including the amount of NPPC transferred to plant in total "NPPC in rates" (col. C)?

RESPONSE: Simply put, consistency. Exhibit CA-304 was intended to mirror the presentation set forth on Exhibit CA-302 (also, HECO-1021, as revised by HECO T-10 June 2007 Update, Attachment 10, page 2), by merely replacing NPPC "as recorded" with NPPC "in rates." Exhibit CA-302 shows the build up in the pension asset since the adoption of FAS87 in 1987 by comparing the total NPPC "as recorded" with the contributions that were made to the pension trust fund on an annual basis, without regard to the fact that HECO annually transfers a portion of NPPC to plant in service through the credits reflected in Account No. 926.9. Exhibit CA-304 merely replaces the total NPPC "as recorded" amounts with the comparable amount of NPPC "in rates" – starting with the year in which FAS87 was first recognized for ratemaking purposes. The amount of trust contributions is identical in both exhibits.

Furthermore, Exhibit CA-302 compares 100% of the recorded NPPC to 100% of the pension contributions. It would be improper for the NPPC "in rates" on Exhibit CA-304 to be limited to the amount charged to O&M accounts (e.g., about 70% on average) for comparison to 100% of pension contributions, since

the pension asset balance recorded by HECO does not similarly apportion actual NPPC between O&M and capital components.

The purpose of presenting Exhibit CA-304 is to highlight the substantial difference between the "as recorded" NPPC, which drives the pension asset balance, and NPPC paid by ratepayers "in rates" over the years. If the cumulative amount of NPPC "in rates" approximated the cumulative NPPC "as recorded," the pension asset balance at December 2007 should be reasonably close on both Exhibits CA-302 and CA-304. However, because the NPPC "as recorded" and NPPC "in rates" are materially different, the pension asset balance December 2007 is also materially different – a positive \$59.4 million (Exhibit CA-302) vs. a negative \$53.8 million (Exhibit CA-304).

However, even if an overly conservative and inappropriate assumption were made that the NPPC "in rates" should be reduced by, say 30%, to reflect a transfer to plant in service, the resulting pension asset balance on Exhibit CA-304 would still be a negative \$8 million (increase the negative \$53.7 million pension asset balance by 30% of the total NPPC in rates of \$152.5 million would yield a revised balance of \$8 million), nowhere near the positive \$59.4 million HECO seeks to include in rate base.

HECO/CA-IR-303 **Ref: CA-T-3, pages 34-46.**

- a) Is it the Consumer Advocate's position that ratepayers have funded the "pension asset" claimed by HECO?

RESPONSE: It is the Consumer Advocate's position that no party has "funded" the pension asset balance that HECO seeks to include in rate base. Referring to Exhibit CA-302 (also, HECO-1021, as revised by HECO T-10 June 2007 Update, Attachment 10, page 2), the only amounts "funded" are the contributions to the pension trust reflected in the column titled "Trust Contributions." It cannot be overstated or overemphasized that HECO is not seeking to include the "Trust Contributions" in rate base. Rather, HECO is seeking to include in rate base the amount of cumulative contributions in excess of cumulative NPPC "as recorded" by the Company—a difference resulting from an accounting entry that does not represent any funded amounts. Virtually the entire pension asset "difference" (i.e., 97.74% per Exhibit CA-302) that HECO seeks to include in rate base is directly attributable to the calendar years in which the Company recorded negative NPPC – negative amounts that have never been recognized in setting utility rates.

It is the Consumer Advocate's position that ratepayers have provided HECO with the amount of NPPC included "in rates" not the amount of NPPC "as recorded" by HECO. Because of the extreme volatility in the amount of NPPC recorded by HECO each year and the infrequency of HECO rate cases between 1991

and 2005, it is the Consumer Advocate's position that the utility rates HECO has charged to ratepayers over the years have provided more than adequate compensation to the Company and that rate base inclusion of any portion of the pension asset would be inappropriate and unreasonable.

- b) If the response to (a) is yes, please explain how ratepayers have provided the funds.

RESPONSE: See the response to part a. above.

- c) Is it the Consumer Advocate's position that amounts contributed to the Pension Fund in excess of the NPPC amount (in years in which the NPPC was positive) were funded by ratepayers? If yes, please explain?

RESPONSE: See the response to part a. above. In addition, it is the position of the Consumer Advocate that, since 1991 when FAS87 was first recognized for ratemaking purposes by this Commission, the cumulative amount of NPPC included in HECO's utility rates has significantly exceeded the cumulative amount of HECO's contributions to the pension fund. As documented by Exhibit CA-304, the amount of NPPC included in rates is estimated at \$152.5 million or about \$53.7 million more than the \$98.8 million HECO contributed to the pension fund during the period 1991-2007.

- d) Does the Consumer Advocate agree that contributions made to the Pension Fund that are in excess of the NPPC result in a lower NPPC in future years (than if only NPPC had been contributed)? If no, please explain.

RESPONSE: Assuming a positive return on plan assets, any scenario analysis that compares future NPPC resulting from two different contribution amounts should produce a lower future NPPC value under the scenario with higher pension fund contributions. However, as set forth on Exhibit CA-302, HECO made "zero" contribution to the pension fund in four of the five years in which the Company recorded "negative" NPPC. For pension asset accounting purposes, "zero" may be larger than a "negative" NPPC amount, but a "zero" contribution does not result in a lower NPPC in future years.

- e) Is it the Consumer Advocate's position that HECO's rates set in HECO's 1995 rate case were too high during the period from 1996 to 2005, and should have been reduced to reflect the decrease in NPPC from the estimate used in determining revenue requirements in the 1995 test year rate case?

RESPONSE: The basis for the Consumer Advocate's position on whether the pension asset should be recognized in HECO's rate base as explained in response to part a. above should be not construed to imply that the Consumer Advocate believes that the rates during the period from 1996 to 2005 were overstated. A determination as to whether the rates established in Docket No. 7766 were too high

or low cannot be made on the basis of a single expense such as the NPPC during the years subsequent to the 1995 Test Year. Rather, as explained in CA-T-1, ratemaking is dynamic and the reasonableness of the authorized rates depends on a determination of whether the rates provide the utility with an opportunity to recover a reasonable level of operating expenses and provide a reasonable net income after taxes (i.e., the return on rate base).

However, to understand the issue of whether HECO's proposal to include the pension asset in rate base is reasonable, one must focus on the basis for such proposal—namely the NPPC and the contributions that were made to the pension trust fund. The two analyses HECO attempts to link by this very information request (i.e., whether the rates established using a 1995 test year were too high or too low and whether HECO should be allowed to include the pension asset in the 2005 and 2007 test year rate base) are not related.

It should also be noted that, as observed by HECO in response to part a. of CA-IR-149 (page 2), the Company files reports in compliance with Commission rules and orders that provide HECO's results of operations, including returns on investment and common equity, that can be used by the Commission to determine whether a formal rate investigation may be warranted outside the context of a utility initiated rate case.

According to HECO, the Commission did initiate such an investigation in 1997, but concluded that no rate change was warranted (Docket No. 97-0073, Decision and Order No. 16710).

However, such a detailed investigation is not necessary for the Consumer Advocate to observe that the amount of NPPC included "in rates" in the 1995 rate case was significantly higher than the NPPC "as recorded" by HECO during that period from 1996 to 2005. Until new rates are established, one must assume that the Company continues to collect from ratepayers the revenue requirement elements upon which the existing rates are based (i.e., unadjusted from the levels included in utility rates) even though, in reality, actual costs incurred by the utility are not identical to the estimates embedded in the test year. Based on this reasonable and necessary assumption, HECO continued to recover the NPPC amounts that were recognized by the Commission in determining the rates for Docket No. 7766 until Interim Decision and Order No. 22050 was issued in Docket No. 04-0113.¹

Referring to Exhibit CA-303, the cumulative amount of NPPC included in HECO's utility rates (\$152.5 million) significantly exceeds the cumulative amount of NPPC recorded by HECO (\$48.2 million) by about \$104.3 million during the period 1991-2007.

¹

This assumption is consistent with various regulatory amortization and cost tracking mechanisms that link the amount of recoverable costs to the difference between actual cost levels and the comparable amount embedded in utility rates (e.g., DSM, ECAC, etc.).

And, based on this information, it is the Consumer Advocate's position that it would now be improper to include the pension asset in rate base – unless and until the excess NPPC included “in rates” above the NPPC “as recorded” is returned to ratepayers.

- f) Did the Consumer Advocate review HECO's filed results of operations following any of the years in which HECO's NPPC was negative (1999-2002, 2004), and assess or make a determination as to whether HECO's rates should be reduced or a rate investigation should be initiated? Please explain.

RESPONSE: See the response to part e. above. In order to support rate base inclusion, HECO T-10, at pages 81-83, makes a tenuous claim that ratepayers have received benefits from the pension asset, including an argument that the negative NPPC recorded by HECO “helped make it unnecessary for HECO to apply for a general rate increase for the ten-year period from 1994 to 2004. It is the Consumer Advocate's position that a utility's decision as to the need for and timing of a rate filing is based on a myriad of factors, not just one element – that one element being the accrual of a non-cash negative expense. Furthermore, the Consumer Advocate contends that HECO's rate case deferral argument does not equate to a “benefit” to ratepayers. If a utility truly has a need for rate relief, the failure to timely file an application for the needed relief could be detrimental to ratepayers in the long run, by sending improper price

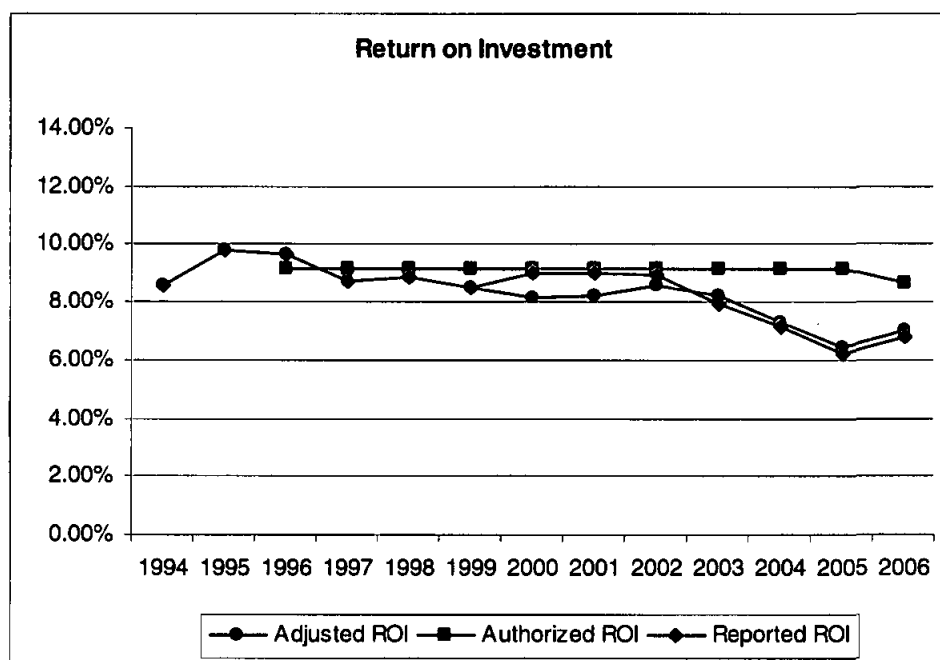
signals to consumers or leading to utility management decisions with adverse consequences. In the absence of any tangible evidence to demonstrate that ratepayers received the benefit of the reduced (i.e., negative) pensions costs recorded by HECO, the Company has presented an "apples" to "oranges" comparison that serves to misdirect the focus of the discussion of this issue.

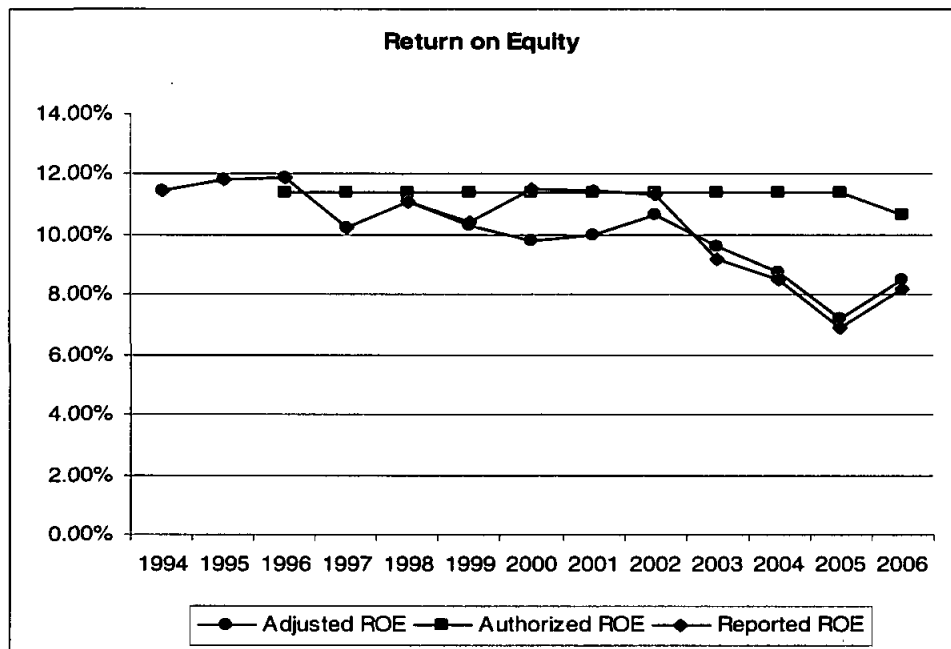
Nevertheless, Mr. Carver is not aware of any contemporaneous undertakings by the Consumer Advocate of HECO's earnings during the years (1999-2002, 2004) in which HECO recorded negative NPPC for purposes of assessing or determining whether the Company's rates should be reduced or a rate investigation should be initiated. However, in light of HECO's representations in the 2005 rate case that the existence of negative NPPC in these years contributed to HECO's ability to defer filing a rate case until the 2005 proceeding (Docket No. 04-0113), thereby benefiting ratepayers, the Consumer Advocate did review HECO's filed results of operations, as reported to the Commission,² to evaluate whether the absence of negative NPPC in calendar years 1999-2002 and 2004 would have had a material impact on HECO's achieved returns on investment or common equity.

²

See HECO's calendar year "Rate of Return on Rate Base and on Common Equity" as reported to the Commission and provided in responses to CA-RIR-93 and DOD-RIR-28 (Docket No. 04-0113) and DOD-IR-112 (Docket No. 2006-0386).

The following charts compare the return rates authorized by the Commission with the actual returns reported by HECO and the estimated returns that would have resulted if no negative NPPC had been recorded in 1999-2002 or 2004:





Contrary to HECO's assertion that "the large negative accruals from 2000-2002 were certainly a substantial factor in avoiding the need for a rate increase filing,"³ it is the opinion of the Consumer Advocate that these graphs clearly demonstrate that HECO's recording of negative NPPC during the years 1999-2002 and 2004 did not have a material impact on the achieved returns (i.e., return on average rate base or average common equity) reported by HECO and, as such, did not play a significant role in the ten-year delay between the 1995 rate case and the 2005 rate case.⁴ As such, HECO's claim that ratepayers have benefited from

³ HECO response to CA-IR-149, part a, page 3.

⁴ In other words, the removal of negative NPPC from operating income, adjusting rate base and common equity accordingly, did not cause a dramatic and material drop in achieved returns to support a conclusion that one or more rate case filings would have been required in the absence of HECO recording the negative NPPC on its books and records.

the negative NPPC "that reduced expenses and lowered revenue requirements, which in turn helped make it unnecessary for HECO to apply for a general rate increase for the ten-year period from 1994 to 2004" is not supported by the evidence and should be rejected by the Commission.

Attachments A and B represent the Consumer Advocate's analyses supporting HECO's "as reported" and "as adjusted" financial results, respectively, on which the above graphs were derived.

- g) Is the Consumer Advocate aware of a ratemaking process in Hawaii pursuant to which a utility can request that its rates be kept the same, but that the components of revenue requirements (including NPPC, net of transfers) be reset to reflect current conditions? If yes, please explain.

RESPONSE: It is the opinion of the Consumer Advocate that the existence of such a "process" is neither germane nor relevant to a determination as to whether the pension asset is properly includable in HECO's 2005 and 2007 test year rate base. HECO has failed to produce any tangible evidence of direct ratepayer benefits, instead attempting to devise a framework of unsupported and unquantifiable indirect benefits.

As to the specific question posed by HECO, the Consumer Advocate is not aware of a specific Commission rule or statutory

provision that explicitly addresses the point raised by HECO. However, the Consumer Advocate is also not aware of any Commission rule or statutory provision that would prohibit a utility from making such a filing.

In any event, it is not the recommendation of the Consumer Advocate that such filings should be made by utilities regulated by this Commission. Rather, it is the Consumer Advocate's position that, in the absence of ratemaking treatment or some other demonstrable mechanism conveying benefits of negative NPPC to ratepayers, it is HECO and its investors that have benefited by the negative NPPC supporting the creation of the pension asset the Company seeks to include in rate base. HECO has provided no financial documentation substantiating its claim. Only the Consumer Advocate has presented analyses and factual information supporting the recommended exclusion of the pension asset from rate base.⁵

⁵ See Exhibits CA-302, CA-303 and CA-304 as well as the return rates set forth in response to part f. of HECO/CA-IR-303, including Attachments A and B thereto.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S RESPONSES TO HECO'S INFORMATION REQUESTS** was duly served upon the following parties, by personal service, hand delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR § 6-61-21(d).

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